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No. 89-1620

In The

Supreme Court of the United States

October Term, 1989

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC., NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS, NEW YORK STATE ASSOCIATION OF LIFE UNDERWRITERS, INDEPENDENT INSURANCE AGENTS OF NEW YORK, INC. AND THE PROFESSIONAL INSURANCE AGENTS OF NEW YORK, INC.,

Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Respondent.

MERCHANTS NATIONAL CORPORATION,

Intervenor.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTEREST OF THE AMICUS CURIAE

The National Association of Insurance Commissioners ("NAIC") is a nonprofit, unincorporated association whose membership consists of the insurance supervisory officials of the 50 states, the District of Columbia, the territories and insular possessions of the United States. The NAIC was organized in 1871 to assure the protection of policyholders across the country. As stated in the NAIC's Constitution, the protection of policyholders continues to be the principal objective of the NAIC:

> "Article II. OBJECTIVE
>
> The objective of this body is to serve the public by assisting the several State insurance supervisory officials, individually and collectively, in achieving the following fundamental insurance regulatory objectives:
>
> (1) Maintenance and improvement of State regulation of insurance in a responsive and efficient manner;
>
> (2) Reliability of the insurance institution as to financial solidity and guaranty against loss;
>
> (3) Fair, just and equitable treatment of policyholders and claimants."

II NAIC *Proceedings*, p. iv (1989).

The principal function of the NAIC and each insurance commissioner is to serve the public by assisting these insurance commissioners in overseeing the activities of the insurance industry.

In submitting this brief, the NAIC seeks to demonstrate its interests in this proceeding, which are:

1. To preserve the orderly regulation of insurance in the respective states;

2. To assist the state insurance commissioners in protecting the interests of consumers across the country by preventing inherent coercion and tying arrangements.

At issue in this case is: do non-banking limitations of the Bank Holding Company Act, 12 U.S.C. §§ 1841-1850, apply when a bank holding company engages in non-banking activities through direct ownership and operation of a state-chartered subsidiary bank that sells insurance?

Since the Second Circuit decision has immediate and nationwide consequences, the question presented is a novel one. It has great public importance. The NAIC supports the legal arguments set forth in Sections I, II and III of the Reasons for Granting the Writ of the Petitioners' petition for a writ of certiorari. Additionally, the NAIC respectfully advances some additional arguments of its own. These arguments are set forth below.

This brief is therefore submitted, with written consent of the parties, in support of the petitioners.

ARGUMENT

I. THE SECOND CIRCUIT DECISION CREATES A SIGNIFICANT NATIONWIDE IMPACT ON ALL STATE INSURANCE COMMISSIONERS.

Congress has separated the banking industry and insurance industry for two basic reasons. Those reasons

are: to preserve the financial stability of both industries and to protect their respective customers.

A. THE STATE INSURANCE COMMISSIONERS SEEK TO MAINTAIN THE ORDERLY AND UNIFORM REGULATION OF INSURANCE.

In urging this Court to grant the Petitioners' petition, the NAIC seeks to maintain the orderly and uniform regulation of insurance. The regulation of insurance will be severely hampered if the Second Circuit decision stands. The decision will create numerous problems for insurance commissioners. The two primary problems include: inherent coercion and tying arrangements. In addition, regulatory lines of authority may be blurred.

The regulation of the business of insurance in the United States is left exclusively to the states, pursuant to the McCarran-Ferguson Act, 15 U.S.C. § 1012. On the other hand, banks and other types of financial institutions are regulated by a combination of state and federal banking regulators pursuant to 12 U.S.C. § 1846. Whatever may be the history of federal-state relations in other fields, regulation of banking has been one of "dual" control since the passage of the first National Bank Act of 1864 (13 Stat. 99). *See, National State Bank v. Long*, 630 F.2d 981, 985 (3d Cir. 1980).

The NAIC argues that despite the obvious intent of the law, the Federal Reserve Board of Governors' ("Board") authorization is in excess of its statutory authority. The Board does not have jurisdiction over the activities of a state-chartered bank selling insurance.

Section 4(c)(8) of the Bank Holding Company Act,[1] clearly prohibits all parts of a bank holding company from engaging in insurance activities.

B. THE SECOND CIRCUIT DECISION WILL ALLOW FOR "INHERENT COERCION."

If the Second Circuit decision is allowed to stand, banks and their subsidiaries will use their inherent ability to coerce customers into believing that the purchase of insurance will help them to secure and maintain credit. This would be especially true where the existence of a small business is heavily dependent on a continued source of credit. Coercion is inherent in such situations.

The NAIC argues that allowing banks to sell all types of insurance will result in the practice of coercing joint purchases. In general, the consumer is not so knowledgeable concerning these activities to avoid them. The same considerations relating to the tying of credit life insurance to the extension of credit applies to other types of insurance. Under the Second Circuit decision, banks will still be able to engage in this type of activity regardless of the amount of bank regulation prohibiting this type of activity.

C. THE SECOND CIRCUIT DECISION WILL ALLOW TYING AGREEMENTS.

In addition to this inherent coercion factor, the NAIC argues that tying will occur if the Second Circuit decision

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[1] 12 U.S.C. § 1843(c)(8).

is not overturned. Tying is defined as the sale of a principal product or service (the tying good) upon the condition that the consumer also purchase an ancillary product or service (the tied good) taken from a multi-product seller. Tying arrangements under this definition may take two forms.

First, it may be involuntary; that is, the seller may explicitly coerce the joint purchase. If this occurs, the bank or its subsidiary would be in violation of Section 106 of the Bank Holding Company Amendments of 1970[2] or Section 3 of the Clayton Act.[3]

Second, tie-ins may be voluntary as the joint purchase may occur based upon the consumer's perception that it would increase charges for obtaining the tying product from an implied or indirect suggestion for obtaining the tying product from an implied or indirect suggestion of the seller. This would occur without the buyer being aware that he had purchased the tied product. Voluntary tying (which is also illegal), if proven, is a practice that is elusive and difficult to demonstrate in a court of law.

The State of New York at one time considered implementing prohibitions on lenders who require the purchase of insurance in connection with a loan through a specified agent or from a particular insurer.[4] This proposed legislation included the following additional safeguards against tie-in sales:

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[2] 84 Stat., at 2065.

[3] 15 U.S.C. § 3.

[4] A.B. 5965, S.B. 3428 (Governor's Program Bill No. 31).

- Lenders who sell insurance would be prohibited from soliciting insurance from prospective borrowers prior to approval of their credit application;
- Lenders would be required to provide a 30-day cancellation privilege for policies sold in connection with extensions of credit;
- Lenders would be required to provide a disclosure form to prospective borrowers, together with the credit application, that spells out the customer's rights in connection with the purchase of any insurance required as part of a loan transaction;
- Lenders would be required to accept any policy meeting the lender's objective and uniformly applied minimum standards relating to the coverage required;
- Lenders would be prohibited from engaging in delaying tactics that would penalize borrowers who obtained insurance coverage through agents or brokers or insurers of their own choice not affiliated with the lender; and
- Lenders would be prohibited from charging unreasonable fees in connection with the substitution of an insurance policy.[5]

Under this proposal, the New York Superintendent of Insurance would have the authority to suspend or revoke a bank's insurance license if it engages in anti-competitive practices in the sale of insurance in connection with the making of loans. The Superintendent also would have the authority to obtain an injunction under the Insurance

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[5] "Banks and Insurance: Concerns of a State Regulator," 6 J. of Ins. Reg. 176, 182 (Dec. 1987).

Law against such a bank and could request the Attorney General to bring a civil action on behalf of the people of the State for recovery of treble damages.

The NAIC argues that if the Second Circuit decision is left standing, banks will be able to engage in both types of tying practices because the banking institutions will restrict the consumer's freedom of choice.

Regulation Z, 12 C.F.R. § 226.4(d) (1981), provides that charges for credit insurance must be included in the finance charge. The NAIC further argues that, even though this law makes tying illegal, the sale of other types of insurance by banks will make it extremely difficult to prove and prevent such activities.

When insurance commissioners consider the question of banks selling insurance, the only experience they have had with this type of activity is the sale of credit insurance by the banks. Their response is as follows:

> " . . . Where else can [the insurance commissioner] look to see how the banks will act with regard to the well being of their clients? [The insurance commissioner has] had a great deal of experience with this subject in the state of Tennessee, and in our opinion the banks have acted in an abysmal manner, showing total disregard for their customers. The state of Tennessee had one of the highest prima facie rates for credit life insurance in the United States. For five years [the insurance department] attempted to lower this rate in the General Assembly and were fought tooth and nail by the banks, automobile dealers and finance companies every step of the way. The banks hired a series of the most effective lobbyists in Tennessee to bottle up this legislation. The fact that they were making

enormous profits on this business did not deter them from wanting to continue to overcharge their customers for as long as they could get away with it.

This is equally true in almost all other states in the Union. [The Tennessee Insurance Commissioner knew] of no occasion where the banks in a statesmanlike manner suggested that a reasonable price be put on credit life insurance for the benefit of consumers. In 1983 the bank holding companies even proposed to the Federal Reserve System the elimination of the very small differential that bank holding companies are required to reduce the rate below bank operating companies. They argued that they were at a competitive disadvantage by being unable to charge the higher price to their customers. They felt they had as much right to charge the high credit insurance rates as anyone else."[6]

Under the Second Circuit decision nothing prohibits the bank from selling these other types of insurance products or engaging in the above described activities. The banks claim, with all of the bank regulations, that such activity will not occur. This is not the case. The issue really is, can the insurance commissioner detect these violations, and if so, how can he or she remedy the violations?

Banks want to convince the insurance commissioners under the Second Circuit decision that they will not mishandle traditional insurance products in the same manner that they mishandled credit life insurance. In fact, they even make the point that they will not be able to

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[6] "Tennessee Commissioner Comments on Sale of Insurance in Bank Lobbies; Use of Percentage Leasing Agreements," 4 J. of Ins. Reg. 91, 92 (Mar. 1986).

charge consumers, in the same manner as credit life insurance, because the market will not permit them to do so. If the bankers are incorrect, the insurance commissioners will find it difficult to protect the consumers.

II. THE SECOND CIRCUIT DECISION WILL AFFECT A NUMBER OF PENDING BILLS IN STATE LEGISLATURES.

The issue presented in the Petitioners' petition is one of widespread significance. This case merits review by this Court because of a number of pending bills spawned from the Second Circuit decision. There are over 11 states currently in the process of considering enacting legislation that will allow state chartered banks to sell and underwrite insurance. In the state of Delaware, H. B. 193 was enacted into law on May 30, 1990.[7] This legislation allows banks to underwrite and sell all forms of insurance. More specifically, it authorizes Delaware banks to sell and underwrite all types of insurance directly within the bank rather than through the use of a legally separate subsidiary. In the past, banks would use a legally separate subsidiary to conduct their non-banking activities, especially those activities that entail a significant degree of risk. In addition, state and federal regulators have generally concluded that it is virtually impossible to effectively insulate a bank from its non-banking businesses where those activities are conducted within the same legal entity.

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[7] P.L. 90-223.

Out-of-state banks were instrumental in drafting Delaware H. B. 193. Those banks were very conscious of the corporate structure set out in the legislation. The language allows these entities to side-step federal banking law prohibitions on insurance activities. These prohibitions and the Second Circuit decision are in fact directed at the very activities Delaware H. B. 193 authorizes. The legislation also allows out-of-state banks to circumvent federal banking laws.

The Second Circuit decision thus provides the framework for similar pending legislation which is a scheme that places form over substance in an effort to evade federal banking law limitations on insurance. It creates a banking subsidiary that is really an insurance subsidiary which can engage in inherently coercive acts and tying arrangements.

SUMMARY OF ARGUMENTS

The NAIC vigorously supports the Petitioners' petition to this Court, requesting resolution of this issue. The impact of the Second Circuit decision is nationwide. In light of the pending legislation in several states and the impact that the Second Circuit decision will have on "insurance regulation," the NAIC respectfully requests a review of that decision by this Court.

CONCLUSION

For the foregoing reasons, the NAIC respectfully requests that this Court grant the Petitioners' petition for certiorari.

Respectfully submitted,

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Dated: June 20, 1990